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IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1994

NATIONAL COMMODITY & BARTER ASSOCIATION
and the
NATIONAL COMMODITY EXCHANGE;
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI to the
UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the imposition of $4 million tax penalty on a political and educational association for failure to disclose the identities of its entire membership violates the members' first amendment right to freedom of association recognized in *N.A.A.C.P. v. Alabama*, 377 U.S. 288, 84 S.Ct. 1302 (1964).

PARTIES TO THE PROCEEDING

The parties to the proceeding were the National Commodity and Barter Association, the National Commodity Exchange (NCBA/NCE) and the United States of America.

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OPINIONS BELOW

The opinion of the Tenth Circuit sought to be reviewed is *National Commodity and Barter Association v. United States*, No. 93-1495 (10th Cir. Nov. 20, 1994) reported as unpublished at 42 F.3d 1406 (10th Cir. 1994). The district court opinion of the same name is reported at 843 F.Supp. 655 (D.Colo. 1993). These opinions are reprinted in the accompanying Appendix.

JURISDICTION

The opinion of the court of appeals in this case was filed on November 29, 1994. Petitioners' timely Petition for Rehearing was denied on February 6, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

This case concerns the first amendment of the United States Constitution, and 26 U.S.C. section 6698, which are reprinted in Appendix D.

STATEMENT OF THE CASE

A. Introduction:

The National Commodity and Barter Association ("NCBA") is a non-commercial, non-profit political and educational organization which advocates, inter alia, the abolition of the Federal Reserve system, use of gold and silver in place of paper money, avoidance of credit, and establishment of a national sales tax to replace the income tax.

NCBA's advocacy has taken the form of seminars, picketing, newsletter and book distribution, and radio and television appearances by its representatives. NCBA was founded in 1979 by John Grandbouche. Mr. Grandbouche died in 1986, and since then the association has been headed by Mr. Grandbouche's hand-picked successor, John Voss. Mr. Voss has printed and distributed NCBA's monthly newsletter since 1980. The newsletter generally includes articles about tax and monetary policy issues, home schooling, and recent judicial decisions touching on these areas, book reviews and classified ads for goods and services offered by members. Mr. Voss also maintains a small inventory of books for sale, which are advertised in the newsletter. Mr. Voss also prints and distributes NCBA's multi-volume set of loose-leaf binders known as The Freedom Books, which contain articles, case reprints, book excerpts and lessons on the history of the Constitution, taxation and currency, how to act as a pro se litigant, how to use a law library, and other areas of interest to members. The Freedom Books derived from Mr. Grandbouche's early classroom materials he gathered in the 1970's for an adult education course he taught on the Constitution. Every new member receives a set of NCBA Freedom Books, which are periodically revised by NCBA paralegals.

From 1980 until approximately March of 1990, NCBA offered its members the use of the National Commodity Exchange (NCE), which was a service -- including a bank account -- into which members could deposit currency, checks or precious metals and from which payments to creditors would be made, and gold or silver purchased, as directed by the member. The purpose of the NCE was to facilitate the storage of wealth in something of real value -- gold or silver -- and to provide members with a means of carrying on their financial affairs while boycotting federal reserve banks. The bank account into which members' deposits were made was

a non-interest bearing account, each member maintained control over his assets in the account through his agent, the NCE operator. No member could access funds of another member in the account. Only a few people at NCBA's main office had authorized access to the account. When first using the NCE, a new member would be given an account number by which his share of the account funds were identified. He would also execute an agency contract with the NCE operator, authorizing the NCE to deposit and withdraw funds on behalf of that member. Records of all transactions in the account were sent to the member on behalf of whom the transactions were made. NCE kept few records of its activities. Not all NCBA members ever made use of the NCE; and use of the NCE was limited to NCBA members only.

Beginning in 1985, some members voluntarily contributed to a common civil rights litigation account to be used for NCBA-sponsored litigation as well as for individual members' tax-related litigation. This fund was known as the "Mutual Assistance Plan" or MAP. This service was also limited to NCBA members only.

Other NCBA-supported activities designed to benefit members included the research and development of a high-mileage carburetor, and a program to buy food directly from farmers. These projects and others were curtailed in part by IRS seizure of members' funds and the concurrent drop in the number of members.[1]

A decade of civil and criminal litigation involving NCBA members has produced considerable evidence to show that the association has been under constant surveillance by criminal investigative agents of the IRS since its inception. Several times the court of appeals for the Tenth Circuit has

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[1] NCBA membership peaked at approximately 2,000 in early 1985.

penalized the IRS for overzealous attempts to reveal NCBA's membership lists via illegal searches and seizures,[2] and groundless grand jury subpoenas.[3] The instant litigation is viewed by NCBA as yet another attempt by the IRS to compel disclosure of members' identities, this time in the guise of a tax penalty.

On April 5, 1985, the IRS assessed the first of two civil penalties at issue in this case. Under 26 U.S.C. Section 6700, a penalty for operating an abusive tax shelter, plan or arrangement was assessed against "NCBA/NCE" in the amount of $20,000,000 (twenty million dollars). Notice of the assessment was planned to coincide with searches and seizures at several NCBA offices around the country. In Denver, the IRS seized approximately $2 million in members' gold and silver during the April 5, 1985, raid of NCBA headquarters.[4] Although the district and appellate courts

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[2] *NCBA v. Archer*, 31 F.3d 1521 (10th Cir. 1994)(*Bivens* action against IRS agents who engaged in illegal searches and seizures of NCBA membership lists -- decision reinstated Complaint following district court's dismissal for failure to state a claim); *Voss v. Bergsgaard*, 774 F.2d 402 (10th Cir. 1985)(F.R.Crim P. 41(e) action seeking return of illegally seized property -- decision upheld district court's order for return of property); *Pleasant v. Lovell*, 876 F.2d 787 (10th Cir. 1989)(*Bivens* action against IRS agents who used informant to remove membership information from NCBA offices -- decision reversed district court's order granting summary judgment to IRS agents and remanded for trial, noting that agents would not have immunity if their intention was to circumvent the requirements of the 4th amendment).

[3] *In re First National Bank of Englewood, Colorado*, 701 F.2d 115 (10th Cir. 1983)(reversing district court order refusing to quash a grand jury subpoena for membership records, holding that IRS must show a cogent and compelling need for the information before subpoena can be enforced).

[4] These funds were being held by the association for members who had deposited savings into the National Commodity Exchange, and had chosen to hold their savings in the form of gold and silver.

ordered return of all items taken in Denver, the seized funds were retained under the aegis of the penalty assessment and levy, i.e. the IRS levied on itself in order to avoid return of the gold and silver.[5]

Following the 1985 assessment, NCBA bank accounts were periodically levied until NCBA filed its administrative claim for refund in 1988. During this period, NCBA filed several lawsuits in an unsuccessful attempt to regain the funds.[6]

Following denial of petitioners' claim by the IRS, the case was filed in the district court and the matter was tried in November, 1992. Before trial, the government abated the twenty million dollar penalty under section 6700 to $176,000, but not until it had assessed a new $4,000,000 (four million) penalty under section 6698 for failure to file partnership returns. Both penalties were at issue in the district court. Petitioners' appeal to this Court seeks review of only the partnership penalty issue.

At trial, the government's chief witness was IRS Revenue Agent William Walter, who had calculated the 6698 penalty and the abated 6700 penalty. Mr. Walter testified that he became aware of the NCBA while he was the Denver

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[5] A Minnesota district court found the identical search warrant and affidavit not to be overbroad, contrary to the earlier finding of the 10th Circuit. The Eighth Circuit agreed (Heaney, J., dissenting), and an evenly divided court refused to rehear the matter. *United States v. Stelten*, 867 F.2d 446 (8th Cir. 1989).

[6] *See, e.g., Voss v. Bergsgaard*, 774 F.2d 402 (10th Cir. 1985); *NCBA v. United States*, 625 F.Supp. 920 (D.Colo. 1986), appeal dism'd and opinion below vacated, Nos. 86-1118 & 86-1212 (10th Cir. 1988)(unpublished).

district tax protester coordinator, a position he held from January, 1988 until May, 1989. In that position, he identified 100 to 150 NCBA members whose tax compliance status resulted in investigations or audits. Agent Walter testified that a "brain-storming session" in October or November, 1989, was held to compile and discuss all information gathered by the different IRS divisions concerning the NCBA and its members, and that the meeting included 16 to 20 IRS employees from various divisions in Denver.

The partnership penalty was the "brain child" of the "brain storming" meeting, and was perceived as the most efficient means of collecting the tax deficiencies of some of the members, albeit not necessarily from those who owed it. Agent Walter testified:

> A ... That's the way we had been approaching the NCBA, was identifying known members and, first of all, seeing what their situation was, if they'd filed tax returns. And at least as far as I was involved in the examination division, I was focusing exclusively on those that had not filed tax returns.
>
> Q And you were looking for an efficient vehicle for collecting taxes from these individuals and it occurred to you at the IRS that approaching the organization and deeming that to be a partnership would be a much more efficient way of collecting money from these individuals than pursuing them individually; right?
>
> A It occurred at that meeting, first of all--

Q Well, that's--can you answer that yes or no?

A Yes. Yes.

As a consequence, the hundreds of other NCBA members who did not have outstanding tax deficiencies are now liable for a $4 million penalty because they were in the same organization as the 150 whose debts prompted the partnership penalty assessment.

The government's version of the NCBA partnership alleged of a conspiracy to defeat the lawful functions of the IRS, in which each member of the NCBA was a partner/co-conspirator. Under the government's theory, the profits generated by the partnership were "saved-taxes-profits," i.e. moneys that would have been paid in taxes but for the members' ability to conceal income and assets from government scrutiny by maintaining funds in the National Commodity Exchange. The IRS theory fails to account for the legitimate political objectives of the NCE, e.g., replacing the income tax with a national sales tax and replacing federal reserve notes with currency backed by gold and silver issued by the federal government.

The government's partnership theory concerning the Exchange assumed that everyone who deposited money into the Exchange did so with the intent to evade income reporting or tax collection obligations, and that the depositors disclosed those intentions to the Exchange operators.[7] IRS representa-

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[7] This theory was most recently rejected in April, 1994, by the jury which found NCBA Director John Voss, and Exchange (NCE) operators, Brent and Mitchell Beals not guilty of conspiracy to impair, impede, obstruct and defeat the IRS in the ascertaining, computing, assessing and collecting federal income taxes. *United States v. Voss, et als.*, No. 93-CR-163 (D.Colo).

tives in other cases have agreed that the operation or use of a warehouse exchange is in itself legal. Indeed, IRS CID Agent Howard Mulholland, acting undercover as Howard Hudson, was trained in Denver and operated an NCBA-affiliated exchange in Kansas City, Missouri for four months.

In the alternative, the government asserted that member/partners were entitled to share in the "profits" generated by sales of books, legal research, pre-paid legal "insurance," and fees charged on NCE deposits, for which the member/partners themselves had paid. Under this theory, the fees earned at the expense of the partners were partnership profits, reportable on a Form 1065 partnership return.[8]

Under cross-examination, Agent Walter agreed that NCBA met none of the *Luna* criteria,[9] e.g., NCBA members had no joint control of assets; there was no agreement to share profits or losses; there was no partnership agreement; and the members did not engage in business in their joint names. As to the NCE users, Walter conceded that there was no joint control over members' accounts and that each Exchange user conducted his or her transactions through the Exchange with their agent pursuant to an agency contract. Walter also agreed, contrary to his initial penalty assessment report, that any NCBA member who did not have an account with the NCE "would not be a partner of the partnership."

Walter identified the partners' distributive shares to be the net proceeds after expenses for anyone sharing in (a) the legal insurance fund (MAP); (b) the book and newsletter distribution department; or (c) the proceeds generated by Exchange services. For the Exchange users, the distributive

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[8] The logical extension of the Service's reasoning in this case would label every bank as being in partnership with its customers and every political organization as being in partnership with its adherents.

[9] *Luna v. Commissioner*, 42 T.C. 1067 (1964).

share would be the increase in value of whatever gold or silver was held in their account, valued at the end of the year, regardless of whether the increase was realized.

By statute, a 6698 penalty is calculated with reference to the number of partners ($50 per partner per month, not to exceed 5 months in any one year -- NCBA's penalty was for 10 years of non-filing). NCBA argued that: (1) it was either not a partnership, or at most a joint venture of a handful of individuals who had made a living while operating the NCBA and its various departments; (2) arguably this smaller group could be labeled a partnership, but the only penalty under 6698 would be based on approximately 10 "partners" not the 1,000 to 1,800 members which the organization had during the period 1979 - 1988; and (3) accordingly, the penalty for failing to file partnership returns would total approximately $25,000, not the $4,223,000 claimed by the IRS.

B. Procedural History:

Jurisdiction in the district court was conferred by sections 7422 of Title 26 and 1346(a)(1) of Title 28, which permit petitioners to pursue a claim for refund of funds held by the Internal Revenue Service, following denial of an administrative claim made directly to the agency.

The original Complaint in this case was filed on November 2, 1989, and sought a refund of the more than $2 million seized in connection with the 6700 penalty.[10] A year after the Complaint was filed, the IRS unilaterally abated the penalty by more than 99 percent.[11] In the interim, the IRS

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[10] Petitioners do not seek review of the lower courts' decisions concerning the 6700 penalty.

[11] The abatement was ostensibly due to a clarification in how a 6700 penalty was to be calculated. Under the new law, IRS claimed it was owed $176,000, not the original $20,000,000.

assessed a new $4,223,000 penalty under 26 U.S.C. Section 6698 for failure to file partnership returns. This allowed the IRS to retain the seized precious metals and funds; consequently, the Complaint was amended prior to trial to contest the issue of NCBA's status as a partnership and the amount of liability, if any, for such a penalty.

After a bench trial before the district court in Denver, the court agreed that the IRS theory of partnership was best made in relation to those members who used the National Commodity Exchange, but since no evidence was presented to show just how many people were NCE depositors, the court used the total membership numbers as calculated by IRS and upheld the partnership penalty in full.

The court of appeals affirmed, in an anomalous holding that NCBA had not preserved the issue whether it had "reasonable cause" for not filing partnership returns; at the same time, the court conceded that NCBA had presented at trial the question whether it was a much smaller partnership than alleged by IRS and whether NCBA's status as a political organization insulated it from the penalty. The court ruled:

> Although the NCBA raised [these] arguments ... in support of its reasonable cause claim in the district court as independent grounds for relief, it has not asserted these claims independently on appeal. Thus, by its own failures or inactions, NCBA rendered it inappropriate for us to consider the above theories of relief on appeal.[12]

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[12] Appendix at B - 5.

In fact, petitioners' opening brief on appeal included these very same arguments, and counsel had focused during oral argument on the question of the correct number of partners. Yet the court of appeals had irrationally circumvented the question of NCBA's liability for the partnership penalty by finding that the concept of "reasonable cause" was new to the petitioners' case.[13] By statute "reasonable cause" is the only defense to a partnership penalty. The court's ruling is equivalent to a finding that after trial, a criminal defendant was estopped from arguing the wrongfulness of his conviction because he never said he was not guilty.

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[13] This holding appears to run afoul of the principle announced in *Lebron v. National Railroad Passenger Corp.*, __ U.S. __, __, 115 S.Ct. 961, 965 (1995), to the effect that an argument fairly embraced within an issue raised can be passed upon by the reviewing court, and that parties are not limited to precise arguments raised below.

ARGUMENT

I. THE ANOMALOUS RESULT OF THE LOWER COURTS' DECISIONS IS THE CREATION OF A PARTNERSHIP WHOSE PROFITS ARE DERIVED EXCLUSIVELY AT THE EXPENSE OF ITS PARTNERS, IN VIOLATION OF THIS COURT'S LONG-STANDING DECISION IN *COMMISSIONER V. CULBERTSON*, AND ITS PROGENY.

In *Commissioner v. Culbertson*,[14] this Court set forth the standard to be used in determining the existence of a partnership, citing an earlier decision, the Court stated:

> ... [A] partnership is created 'when persons join together their money, goods, labor, or skill **for the purpose of carrying on a trade, profession, or business** and when there is community of interest in the profits and losses.' ... A partnership is, in other words, an **organization for the production of income** to which each partner contributes one or both of the ingredients of income -- capital or services.
>
> * * *

[14] 337 U.S. 733, 69 S.Ct. 1210 (1949).

> The question is ... whether, considering all the facts -- the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent -- the parties in good faith **and acting with a business purpose** intended to join together in the present conduct of the enterprise.[15]

The Tax Code also defines partnership as including:

> a group, ... joint venture, or other unincorporated organization through or by means of which **any business, financial operation, or venture is carried on**, and which is not, within the meaning of this title a corporation, a trust or an estate.[16]

Although the district court agreed that NCBA was not run as an organization for profit, it found that it must be classified as some form of taxable entity because revenue was indeed generated, primarily by the Exchange fees charged to user/members. The court rejected the government's "saved-taxes-profit" theory, since no evidence was presented to show that all members held an intent to evade tax obligations through their use of the Exchange, indeed fewer than half of the members used the Exchange. But the court stopped short

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[15] *Id.* at 740 & 742, 69 S.Ct. at 1213 & 1214 (emphasis added).

[16] 26 U.S.C. Section 761 (emphasis added).

of finding that the partnership label could only be properly applied to those who actually made a living off the members' payments. As a result, partners were created where there was no evidence of intent to share in loss or gain, individually or collectively. The logical extension of this ruling would make partnerships of banks and their customers, the Audubon Society and its members, or the Democratic Party.

II. THE LOWER COURTS HAVE FORCED DISCLOSURE OF IDENTITIES OF MEMBERS UNDER THE AEGIS OF THE PARTNERSHIP PENALTY, IN VIOLATION OF WELL-ESTABLISHED PRECEPTS OF THE FIRST AMENDMENT.

The NCBA has previously been protected by the Tenth Circuit Court of Appeals from compelled disclosure of its membership list by subterfuge,[17] illegal search warrant,[18] grand jury subpoena,[19] and discovery requests.[20]

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[17] *Pleasant v. Lovell*, 876 F.2d 787, 804 (10th Cir. 1989)(rev'g summary judgment for defendant IRS agents in *Bivens* action brought by NCBA members -- "The record is replete with evidence which would support plaintiffs' claim that defendants ... were seeking to gather as much information on the NCBA as possible, including the identities and activities of its members .... [T]his type of activity may constitute governmental interference with the freedom to associate and the privacy in one's associations.").

[18] *Voss v. Bergsgaard*, 774 F.2d 402, 406 (10th Cir. 1985)(upholding order to return items illegally seized by IRS agents under an overbroad warrant and via an overbroad execution of that warrant from NCBA's offices, noting that much of the material taken was literature protected from seizure by first amendment considerations -- "Certainly [NCBA's] advocation of modifying or abolishing our country's tax system is a legitimate activity. Indeed it is an activity protected by the first amendment"); *NCBA v. Archer*, 31 F.3d 1521 (10th Cir. 1994)(*Bivens* action based on the illegal seizures in *Voss v. Bergsgaard*, court reversed dismissal for failure to state a claim, finding complaint stated first and fourth amendment grounds for monetary damages).

[19] *In re First National Bank of Englewood*, 701 F.2d 115, 118 (10th Cir. 1983)(recognizing that enforcement of a grand jury subpoena to obtain NCBA membership records may have a chilling effect on members' right to associate freely and anonymously).

[20] *Grandbouche v. Clancy*, 825 F.2d 1463 (10th Cir. 1987)(rev'g (continued...)

Despite these precedents and the lack of any notice of a duty to file partnership returns, the lower courts found that all NCBA members can be penalized for not revealing their names as "partners" on partnership return forms 1065. 26 U.S.C. Section 6031(a) requires every partnership to make a return stating, in part, "the names and addresses" of every partner. Surely "reasonable cause" exists for failing to disclose membership information on a partnership return which courts have repeatedly held to be privileged.[21]

The IRS has employed the partnership principle to achieve an impermissible goal, i.e. punishing individuals because of their association with one another.

N.A.A.C.P. v. Claiborne Hardware Co.,[22] provides a useful analogy to the case at hand since both involve an effort to boycott established institutions. In *Claiborne*, the NAACP's boycott targeted white-owned businesses in Claiborne County, Mississippi, whereas the National Commodity Exchange targeted the Federal Reserve system by

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[20](...continued)
dismissal of NCBA member's *Bivens* action for failure to provide membership identities in response to discovery request by defendant IRS agents, in the absence of a showing that the information is sufficiently important to compel its production in light of the first amendment implications present here).

[21] *See e.g., Voss v. Bergsgaard*, 774 F.2d 402, 406: "the organization's advocation of modifying or abolishing our country's tax system is a legitimate activity. Indeed, it is an activity protected by the first amendment." Section 527 of Title 26 exempts "political organizations" from filing returns. Even assuming arguendo that NCBA failed to satisfy all criteria provided by Section 527, NCBA thought it was exempt based on the Tenth Circuit's repeated affirmation that NCBA was a political organization protected by the First Amendment, thereby providing reasonable cause for failing to file partnership returns.

[22] 458 U.S. 886, 918-920, 102 S.Ct. 3409 (1982).

encouraging and enabling members to eschew traditional commercial banks.

The theory underlying the partnership penalty runs afoul of this Court's ruling in *Claiborne*:

> The First Amendment ... restricts the ability of the State to impose liability on an individual solely because of his association with another. In *Scales v. United States*, 367 U.S. 203, 229 ... [1961], the Court noted that a "blanket prohibition of association with a group having both legal and illegal aims" would present "a real danger that legitimate political expression or association would be impaired." The Court suggested that to punish association with such a group, there must be "clear proof that a defendant 'specifically intend[s] to accomplish [the aims of the organization] by resort to violence.'" *Ibid.* (quoting *Noto v. United States*, 367 U.S. 290, 299, 81 S.Ct. 1517, 1521,... [1961]). Moreover ... this intent must be judged "according to the strictest law," for "otherwise there is a danger that one in sympathy with the legitimate aims of such an organization, but not specifically intending to accomplish them by resort to violence, might be punished for his adherence to lawful and constitutionally protected purposes, because of other and unprotected purposes which he does not necessarily share."

* * *

> ... Civil liability may not be imposed merely because an individual belonged to a group, some members of which committed acts of violence. For liability to be imposed by reason of association alone, it is necessary to establish that the group itself possessed unlawful goals and that the individual held a specific intent to further those illegal aims. "In this sensitive field, the State may not employ 'means that broadly stifle fundamental personal liberties when the end can be more narrowly achieved.'[23]

The Court condemned the lower court's "insubstantial findings of fact screening reality."[24] The trial court had relied on many of the defendants' regular attendance at NAACP meetings to hold those individuals liable for damages.[25]

> To impose liability for presence at weekly meetings ... would -- ironically -- not even constitute "guilt by association," since there is no evidence that the association possessed unlawful aims. Rather, liability could only be imposed on a "guilt <u>for</u> association" theory. Neither is permissible under the First Amendment.[26]

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[23] *Id.* at 918-920, 102 S.Ct. at 3428-29 (footnotes omitted).

[24] *Id.* at 924, 102 S.Ct. at 3431, quoting *Milk Wagon Drivers v. Meadowmoor Dairies, Inc.*, 312 U.S. 287, 293, 61 S.Ct. 552, 555 (1941).

[25] *Id.* at 897 & 924, 102 S.Ct. at 3417 & 3431.

[26] *Id.* at 925, 102 S.Ct. at 3432.

Even though some evidence of violence was presented concerning a few defendants,[27] this Court rejected the judgment of the lower court assessing liability against many more defendants, including the NAACP chapters themselves:

> A massive and prolonged effort to change the social, political, and economic structure of a local environment cannot be characterized as a violent conspiracy simply by reference to the ephemeral consequences of relatively few violent acts.... A court must be wary of a claim that the true color of a forest is better revealed by reptiles hidden in the weeds than by the foliage of countless freestanding trees.[28]

The use of a partnership label to implicate all NCBA members in an alleged tax evasion partnership runs afoul of the same "insubstantial findings, screening reality" which this Court faced in *Claiborne*. By focusing on members who violated civil or criminal tax requirements, the IRS claims the true color of NCBA is revealed by "reptiles hidden in the weeds," and, because these reptiles belonged to the same organization as many hundreds of others, the 6698 penalty is alleged to be appropriate, in the absence of any evidence that those others ever agreed to engage in tax evasion. Likewise, the penalty imposes $4 million of liability, jointly and severally on hundreds of people who had no control over the filing of a partnership return that was arguably due from the few in joint control of the daily activities at NCBA.

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[27] *Id.* at 897-98, 102 S.Ct. at 3417.

[28] *Id.* at 933-34, 102 S.Ct. at 3436.

IRS bears the burden of proof when it alleges fraudulent conduct on the part of a taxpayer.[29] It must establish the taxpayer's fraud by clear and convincing evidence.[30] Even though the agency did not meet that burden as to each "partner," the lower courts upheld the penalty based on the assumption that each "partner" knowingly engaged in a conspiracy to commit tax evasion.

> Recognizing that guilt by association is a philosophy alien to the traditions of a free society . . . and the First Amendment itself, we have held that civil or criminal disabilities may not be imposed on one who joins an organization which has among its purposes the violent overthrow of the Government, unless the individual joins knowing of the organization's illegal purposes . . . and with the specific intention to further those purposes.[31]

The Section 6698 penalty exemplifies "means that broadly stifle fundamental personal liberties, when the end can be more narrowly achieved." Application of a partnership label to all NCBA members accommodates such broad means, and has resulted in unjust application of Title 26 provisions to NCBA's activities.

The 6698 penalty is rarely assessed, as is evidenced by the dearth of case law under this section of the Code. Its

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[29] 26 U.S.C. Section 7422(e).

[30] *Breland v. United States*, 323 F.2d 492 (5th Cir. 1963); *Putman v. United States*, 301 F.2d 751 (6th Cir. 1962).

[31] *N.A.A.C.P. v. Claiborne, supra*, at 932, 102 S.Ct. at 3435-36, quoting *NAACP v. Overstreet*, 384 U.S. 118, 122, 86 S.Ct. 1306, 1308 (1966)(Justice Douglas, dissenting)(citations omitted).

infrequent use by the IRS may be due to the fact that a partnership return Form 1065 is classified as an "information return" and is not accompanied by a payment. The return merely informs the IRS of the nature of the partnership's business, its participants and the gains or losses they will claim on their individual returns. Failure to file the return deprives the agency of information, but not revenue. The penalty simply does not implicate the same compelling need that the IRS might assert in other contexts. The 6698 penalty is a thinly-veiled attempt to once again compel disclosure of the NCBA membership list without adequate cause, neatly circumventing earlier decisions requiring that the government demonstrate a cogent and compelling need for members' identities. The IRS seizure and retention of a substantial portion of the net worth of the NCBA's members has crippled the association and muzzled one of the IRS's largest and most strident critics.

In this case the echoes of *N.A.A.C.P. v. Alabama*,[32] are unmistakable. The State of Alabama imposed a civil penalty of $100,000, and an injunction prohibiting speech and associational activities based on NAACP's refusal to disclose its membership list. This Court held "that the compelled disclosure of the names of the petitioner's members would entail 'the likelihood of a substantial restraint upon the exercise by petitioner's members of their right to freedom of association.'"[33]

The Alabama courts held that technical procedural defaults prevented the NAACP from obtaining relief, similar to the lower court's proffered rationalizations in the instant case.[34] This Court rejected such excuses, holding:

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[32] 377 U.S. 288, 84 S.Ct. 1302 (1964).

[33] *Id.* at 308, 84 S.Ct. at 1314 (citations omitted).

[34] *See, id.* at 295-97, 84 S.Ct. at 1307-08; *cf.* Appendix at B - 4-5.

> The consideration of asserted constitutional rights may not be thwarted by simple recitation that there has not been observance of a procedural rule with which there has been compliance in both substance and form, in every real sense.[35]

Petitioners herein have complied in both substance and form in every real sense with the procedural rules that entitle them to an adjudication on the merits of their claim that the size of the partnership penalty sub judice violates their right to associate for collective advocacy.

> This case, in truth, involves not the [duty of a joint venture to disclose its participants], but rather the freedom of individuals to associate for the collective advocacy of ideas. "Freedoms such as * * * [this] are protected not only against heavy-handed frontal attack, but also from being stifled by more subtle governmental interference."[36]

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[35] 377 U.S. at 297, 84 S.Ct. at 1308.

[36] *Id.* at 309-10, 84 S.Ct. at 1315 (citation omitted).

CONCLUSION

The important federal question presented here which the Tenth Circuit decided in conflict with applicable decisions of this Court is whether the imposition of a penalty exceeding four million dollars for failure to disclose its membership list violates the first amendment freedoms of NCBA members to associate for collective advocacy. The importance of this question requires that this Court grant the requested writ.

WHEREFORE petitioners request that this Court grant their Petition for a Writ of Certiorari to review and reverse the decision of the Tenth Circuit and remand for recomputation of the amount of the tax penalty at issue.

Respectfully submitted,

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APPENDIX

APPENDIX A - 1

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 89-M-1912

NATIONAL COMMODITY AND BARTER ASSOCIATION/NATIONAL COMMODITY EXCHANGE,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

MEMORANDUM OPINION AND ORDER

MATSCH, Judge

The National Commodity and Barter Association/National Commodity Exchange (NCBA/NCE) brings this suit against the United States for a refund of penalties assessed under I.R.C. Section 6698 for failing to file partnership returns for the years 1979-1988 and I.R.C. Section 6700 for promoting an abusive tax shelter. This court has jurisdiction over the matter pursuant to I.R.C. Section 7422 and 28 U.S.C. 1346(a)(1). A trial to the court was held November 16-19, 1992 and December 30, 1992. Extensive post-trial briefs were filed. This memorandum opinion constitutes the findings of fact and conclusions of law required by F.R.Civ.P. 52(a).

The NCBA, founded in 1979, is a self-described "voluntary, non-commercial, political and educational

association." Amended Complt. para. 1. The NCBA operated a warehouse bank or warehouse exchange known as the National Commodity Exchange, or NCE. On April 5, 1985, the IRS levied a $20,000,000 jeopardy assessment against the NCBA pursuant to I.R.C. Section 6700 for promoting an abusive tax shelter by disseminating false and fraudulent statements concerning the federal tax laws. Concurrent with the jeopardy assessment, under a search warrant, the IRS conducted a search and seizure at the NCBA's offices in Denver, Colorado, seizing cash and coins, as well as gold and silver bullion. The IRS also placed levies against NCBA bank accounts. Though the search and seizure was held unconstitutional, see Voss v. Bergsgaard, 774 F.2d 402, 406 (10th Cir. 1985), the IRS served a levy on itself and retained the NCBA's assets to satisfy the $20,000,000 jeopardy assessment. On March 2, 1988, the NCBA filed a claim for refund with the IRS. This action was filed more than six months subsequent to that date on November 2, 1989 pursuant to I.R.C. Section 6532(a)(1).

On June 22, 1990, the IRS assessed $4,223,000 in penalties against the NCBA under I.R.C. Section 6698 for failing to file informational partnership tax returns for the years 1979-1988. By a letter dated January 31, 1991, the IRS notified the NCBA that it had abated the Section 6700 penalty to $176,822 after a number of courts had disapproved the method by which the penalty was calculated. See, e.g., Gates v. United States, 874 F.2d 584, 587 (8th Cir. 1989). Under the new computation method, the IRS penalized the NCBA/NCE based on a percentage of its gross income, which the IRS determined to be $1,384.226 for the years 1982-1985. The IRS applied the overpayment from the Section 6700 abatement to the Section 6698 penalties, notifying the NCBA by a letter dated April 18, 1991. The NCBA/NCE filed a claim for refund for the Section 6698 penalties for the years 1979-1983 on June 15, 1992. The IRS disallowed the claim

in a July 24, 1992 letter. An amended complaint seeking refund of the Section 6698 penalties was filed in this court on August 7, 1992. The amended complaint also seeks an injunction against the IRS to keep it from enforcing the Section 6698 penalties for 1984-1988.

The NCBA/NCE was conceived by John Grandbouche, a onetime candidate for lieutenant governor of Colorado and full-time proponent of libertarian and anti-monetarist ideas. After Grandbouche's death in 1986, John Voss took over as director of the NCBA. The NCBA recruited members and charged annual membership fees ranging from $100 to $180 over the course of the 1980s. It also had honorary members who were not charged membership fees. The NCBA began with about 200 members in 1979. Membership peaked near 2,000 in the early 1980s, but had declined since then on account of the 1985 seizure of the NCBA's assets. At the time of the search and seizure in 1985, the NCBA had approximately 1700 members.

NCBA membership brought certain benefits. NCBA members received a multi-volume set of loose-leaf "Freedom Books." The "Freedom Books" outlined the premises of the NCBA credo, and provided guidance for defending against tax audits and conducting ***pro se*** tax litigation. The first volume sets forth the fundamental tenets of the NCBA. Among those tenets are beliefs: that the originally conceived Constitutional system has been perverted; that the Federal Reserve is an extraconstitutional agency serving the interest of plutocratic banking interests; that the United States is headed for financial ruin because it has abandoned the gold standard; that the federal income tax is unconstitutional; and, specifically, that wages are not subject to taxation because they are not income. The second volume of the Freedom Books is entitled "Legal Briefs and Motions." The volume is a primer for conducting ***pro-se*** litigation and details the state and federal systems and the process of litigation. The third

volume, entitled "Courtroom Procedures," give the NCBA's views on federal court jurisdiction, the role of grand juries and how to appeal an adverse tax ruling.

The Freedom Books also describe the purported advantages of warehouse banking. According to the Freedom Books, warehouse banks back deposits with 'real' assets--gold and silver--and additionally afford depositors absolute privacy against the recordkeeping requirements of the IRS. In practice, the warehouse bank described by the Freedom Books was the NCE, the "service wing" of the NCBA. The NCE was a warehouse bank created, acording to NCBA literature, to function outside of the illegitimate Federal Reserve System and invasive federal banking and tax laws. It was open only to NCBA members. The NCE did what the Freedom Books promised: The NCE converted depositors' Federal Reserve Notes (or"F[e]rns") into gold or silver. The NCE also claimed to give depositors complete privacy in conducting their personal finances. Accounts were numbered, not named. Account records were kept purportedly only for the immediately preceding NCE transaction. The NCE's promotional literature claimed account-holders' records would be beyond the reach of the IRS. Records on computer tape seized by the government show 679 separate accounts at the NCE. Most of the accounts were held by individuals, but some accounts belonged to other warehouse exchanges located about the country.

The NCE maintained checking accounts at several banks in the Denver area. It used depositors' money to purchase precious metals, and held depositors' assets in that form. The NCE also had in place a "price stabilization plan" to protect account-holders' assets from price fluctuations in the precious metals market. This plan required the maintenance of a reserve fund from which the NCE could absorb any losses an account-holder might incur if the price of metals dropped. When an account-holder wanted to withdraw money from his

account, he would notify the exchange. The exchange would then send the account-holder cash via registered mail. Alternatively, the NCE offered a bill paying service, whereby account-holders would notify the exchange of bills they had to pay and to whom. The NCE would then write checks to those parties on the NCE's own account.

The NCE was initially operated by NCBA member Larry Martin. A dispute with Grandbouche in April 1983 over opening up the NCE to non-NCBA members led to Martin's departure. Martin's successor at the NCE was Joseph Gorman, who ran the exchange until March 1985. Gorman also had a falling out with Grandbouche and the NCBA, so much so that he took NCE's backup computer records and turned them over to the government.

The NCBA charged fees to users of the NCE. Joseph Gorman testified that $6000 per month of the service fees were deposited into an NCE account known as the "Founder's Fund." The remainder of the NCE's fees were kept by Gorman to maintain a reserve fund for the NCE, and to pay expenses. The Founder's Fund was under the sole control of John Grandbouche, who used the Founder's Fund deposits to further the mission of the NCBA as he saw fit. Founder's Fund money paid for a variety of NCBA activities, including the development of a high-mileage carburetor, publishing John Brandbouche's books and, after Grandbouche's death, paying his widow's expenses. John Voss assumed control of the Founder's Fund upon succeeding Grandbouche at the NCBA.

The NCE was one of a network of warehouse banks located throughout the country. Joseph Gorman testified that 63 "satellite" exchanges were established through NCBA members. These members paid to attend NCBA training seminars on running warehouse banks. Many of these satellite exchanges maintained accounts with the NCE and traded metals through the NCE.

The NCBA also circulated a monthly newsletter to members. Non-members could subscribe for $15, and later $20, per year. The newsletter covered topics ranging from the efforts of the NCBA movement, to home schooling, to pleas for aid for incarcerated tax offenders, to efforts to develop a high-mileage carburetor, to advertisements for books sold by the NCBA. The NCBA hosted annual seminars for members starting in 1981 and continuing until 1985. At these conclaves, Grandbouche, Voss and other NCBA representatives instructed concerning NCBA teachings.

Yet another activity of the NCBA involved the operation of a "legal department." The legal department charged members $25 and later $40 per hour for assistance to members involved in tax audits and litigation. A "Mutual Assistance Plan" (MAP) was also offered by the NCBA, which functioned as a sort of litigation insurance plan for members involved in civil and criminal tax disputes. The MAP covered an enrollee's litigation expenses up to certain dollar amounts using preapproved NCBA attorneys. In a 1984 promotional videotape, then NCE head Joseph Gorman claims 22 to 23 percent of the NCBA's members were participating in the MAP program.

As this description of NCBA activities indicates, part of the central mission of the organization was resistance to the tax regime. The NCBA and its members have been involved in many federal cases, both civil and criminal. See, e.g., ***Aspinall v. U.S.***, 1993 WL 97611 (D.Colo. 1992), ***aff'd***, 984 F.2d 355 (10th Cir. 1993); ***U.S. v. Becker***, 965 F.2d 383 (7th Cir. 1992), ***cert. denied***, 113 S.Ct. 1411 (1993); ***U.S. v. McKinney***, 952 F.2d 333 (9th Cir. 1991); ***National Commodity and Barter Ass'n v. U.S.***, 951 F.2d 1172 (10th Cir. 1991); ***National Commodity and Barter Ass'n, National Commodity Exchange v. Gibbs***, 886 F.2d 1240 (10th Cir. 1989); ***Hintze v. I.R.S.***, 879 F.2d 121 (4th Cir. 1989); ***Pleasant v. Lovell***, 876 F.2d 787 (1989); ***C.I.R. v.***

Hendrickson, 873 F.2d 1018 (7th Cir. 1989); ***U.S. v. Stelten***, 867 F.2d 446 (8th Cir. 1989), ***cert. denied***, 493 U.S. 828 (1989); ***In re Grand Jury Froceeding***, 842 F.2d 1229 (11th Cir. 1988); ***Voss v. Bergsgaard***, 774 F.2d 402 (10th Cir. 1985); ***Heinold Hog Market, Inc. v. McCoy***, 700 F.2d 611 (10th Cir. 1983); ***U.S. v. Pottorf***, ____ F.Supp. ____, 1993 WL 294446 (D.Kan. 1993); ***U.S. v. Holland***, ____ F.Supp. ____, 1993 WL 330542 (N.D.Okla. 1993); ***National Commodity & Barter Ass'n v. Gibbs***, 790 F.Supp. 233 (D.Colo. 1991); ***Pleasant v. Lovell***, 1990 WL 393737 (D.Colo. 1990), ***aff'd***, 974 F.2d 1222 (10th Cir. 1992); ***U.S. v. National Commodity and Barter Ass'n***, 1990 WL 85905 (D.Colo. 1990); ***Huebner v. U.S.***, 731 F.Supp. 1441 (D.Ariz. 1990); ***U.S. v. Gorman***, 674 F.Supp. 1401 (D.Minn. 1987); ***In re Roberts***, 650 F.Supp. 159 (N.D.Ga. 1987); ***National Commodity and Barter Ass'n v. U.S.***, 625 F.Supp. 920 (D.Colo. 1986); ***U.S. v. Premises Known as 1007 Morningside Ave., Sioux City, Iowa***, 625 F.Supp. 1343 (N.D.Iowa 1985); ***Grandbouche v. C.I.R.***, 99 T.C. 604 (1992). Government exhibit G-11, introduced at trial, catalogs correspondence between presence on NCBA membership and mailing lists with conviction for federal tax related crimes or assertion of frivolous positions in federal tax cases. 401 individuals appearing on the NCBA rolls have been either criminal defendants in tax cases, or have asserted frivolous legal positions in civil tax matters. Nearly half of these individuals had disputes with the IRS before joining the NCBA or before the NCBA was even formed.

The NCBA/NCE did not file federal partnership, corporation, employment or unemployment tax returns from 1979-1988. Neither did the NCBA obtain an IRS ruling that it was a non-profit or tax-exempt organization under I.R.C. Section 501 or a political organization under I.R.C. Section 527.

I. Subject matter jurisdiction

The government initially argues that the NCBA is precluded from arguing many of its positions because it failed to raise them in the Section 6698 refund claim. At trial, the NCBA argued it was a sole proprietorship of John Grandbouche, and after Mr. Grandbouche's death, John Voss became the sole proprietor. Alternatively, the NCBA argued that it was a political party under I.R.C. Section 527.

The government claims that these two positions were not raised in the NCBA's claim for refund filed with the IRS and thus tis court is without subject matter jurisdiction to entertain those arguments. I.R.C. Section 7422(a) requires that prior to maintaining a suit in a district court, a taxpayer must file a claim for refund with the IRS "according to the provisions of law in that regard and the Regulations of the Secretary in pursuance thereof." One such regulation requires that a claim for refund must "set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof." 26 C.F.R. Section 301.6402-2(b)(1).

In ***Herrington v. United States***, 416 F.2d 1029, 1032 (10th Cir. 1969), the Tenth Circuit Court of Appeals ruled that a taxpayer seeking a tax refund could not raise legal or factual bases for a refund that were not originally raised in the claim for refund filed with the IRS. See also, ***Angle v. United States***, 996 F.2d 252, 254 (10th Cir. 1993); ***United States v. Felt & Tarrant Mfg.***, 283 U.S. 269 (1931); ***Angelus Milling Co. v. Commissioner***, 325 U.S. 293, 299 (1945). For a court to have jurisdiction under Section 7422, Herrington requires that: "[T]he grounds relied on in a suit for refund must be reasonably encompassed by those set out in the claim for refund." ***Id.*** at 1032. The IRS can waive this formal requirement, but can do so only by addressing the merits of the claim asserted. ***Angelus, supra***, at 297. The

purpose of this principle is to provide the IRS with adequate information to consider claims and thus avoid the expense of unnecessary litigation. ***Felt & Tarrant Mfg.***, 283 U.S. at 272. Thus this "variance doctrine," as it is called, functions akin to the procedural default rule in appellate litigation: the claimant here must have already raised its bases for refund in the IRS refund action, or this court is without jurisdiction.

An examination of the NCBA's Section 6698 refund claim (Govt. exhibit K-9) reveals that the NCBA did sufficiently apprise the IRS of these asserted grounds for refund. The NCBA refund claim is suffused with references to its political and ostensibly protected First Amendment activities. Indeed, in a motion for injunction filed in this court and attached to the refund claim, the NCBA accuses the IRS of levying the penalty because of the NCBA's political activities. In sum, the government cannot credibly maintain that the NCBA's refund claim did not apprise it of the NCBA's assertion at trial that it is a political organization. Admittedly, the NCBA's refund application does not explicitly mention I.R.C. Section 527, defining the tax status of political organizations, but ***Herrington*** only requires the bases asserted in court be "reasonably encompassed" in the IRS refund claim. The NCBA's assertion that it is a political organization is so reasonably encompassed.

Similarly the IRS had notice in the refund claim of the position that the NCBA was the sole proprietorship of John Grandbouche. Indeed the government previously maintained that the NCBA was Grandbouche's sole proprietorship. The government claims that the NCBA never took this position in the refund claim, but rather only cited the government's position in other tax court litigation. Examining the claim for refund, it is sufficiently clear that the NCBA informed the IRS reviewer of the IRS' previously held position on the status of the NCBA.

This procedural default-type doctrine is "implicit," not explicit in Section 7422. ***Herrington***, 416 F.2d at 1032. "[T]he manifest purpose of the requirement [that parties state their ground for refund] is to afford the Service an opportunity to consider and dispose of the claim" with less expense and time. ***Id.*** The NCBA's stated grounds in the complaint gave the IRS an opportunity to consider the "NCBA-as-sole proprietorship" argument. Indeed the IRS itself hatched the argument. The NCBA seems to abandon the position that it was a sole proprietorship in its post-trial brief, so the jurisdictional question may be of no consequence. All the same, this court rules that it does have jurisdiction to entertain the proposition that the NCBA was a sole proprietorship for federal tax purposes.

II. The Section 6698 penalty

The pertinent question for the Section 6698 is whether the NCBA/NCE was a partnership for federal income tax purposes. Since IRS has determined a partnership exists, and that determination is supported by a presumption of correctness, the burden is borne by the NCBA to prove that the determination was erroneous. ***Commissioner v. Tower***, 327 U.S. 280, 286 n. 4 (1946), citing, ***Welch v. Helvering***, 290 U.S. 111 (1933).

Obviously, a Section 6698 penalty for failure to file a partnership return, can only be imposed against a partnership. I.R.C. Section 761(a) defines a partnership for federal tax purposes:

> [T]he term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation, a trust or an estate.

The breadth of this definition is underscored by the Treasury Department's gloss on I.R.C. Section 761(a): "[t]he term

partnership is broader in scope than any common law meaning of partnership, and may include groups not commonly called partnerships. 26 C.F.R. Section 1.761(a).

For purposes of Colorado law, the NCBA has been called a partnership. ***Heinold Hog Market, Inc. v. McCoy***, 700 F.2d 611, 615 (10th Cir. 1983). This very court has characterized the NCBA as a partnership. ***National Commodity and Barter Exchange v. United States***, 625 F.Supp. 920, 924 (D.Colo. 1986) (Matsch, J.). Nevertheless, the NCBA's status under the internal revenue code is ultimately a fact-based determination to be made by this court on the facts presented at trial. ***Commissioner v. Culbertson***, 337 U.S. 733, 742 (1949). A determination of an entity's status as a partnership under state law does not foreclose a contrary determination for federal tax law purposes. ***Id.*** at 753. (Frankfurther, J., concurring).

First, let it be said what the NCBA was not. The NCBA never incorporated under the laws of any state thus it is not subject to taxation as a corporation. Nor, quite obviously, is the NCBA subject to taxation as an estate, or a trust. I.R.C. Section 7701(a).

The text of Section 761(a) supports the proposition that the NCBA is a partnership. The NCBA cannot escape the fact that it is a "syndicate, group, pool, joint venture, or other unincorporated organization through or by menas of which any business, financial operation, or venture is carried on...." The NCBA certainly was a "group," or, at the least, an "other unincorporated organization." A "group" has been defined as "a number of individuals bound together by a community of interest, purpose or function." ***Webster's Third New International Dictionary*** 1004 (1971). The NCBA was precisely one such community of interest, advocating specific views regarding taxes and the constitutional order. At the very least, the NCBA was an "other unincorporated association." The breadth of the

statutory term indicates it was designed as a catch-all so as to encompass consciously amorphous associations such as the NCBA.

Furthermore, operation of the NCE constituted a "financial operation." The NCE bought and sold gold and silver, paid members' bills through NCE accounts, charged fees for services, and maintained a price support system for depositors. In short, the NCE performed many of the services of a traditional bank. It was, unequivocally, a "financial operation." Moreover, the NCBA received revenue from memberships, the MAP, the legal department and sales of publications. Admittedly, none of these activities seemed to be carried out in the fashion of a for profit commercial enterprise, but Section 761(a) contains no such requirement. By its terms alone, the statute encompasses an organization such as the NCBA/NCE.

The NCBA does not substantially dispute that the broad terms of I.R.C. Section 761(a) capture it within, what it calls, the IRS "pigeonhole" of a partnership. Rather, the NCBA turns to court interpretations of what constitutes a partnership. The definition of a partnership in the case law is considerably more restricted than the inclusive terms of I.R.C. Section 761(a). The Supreme Court described a partnership as:

> [W]hen persons join together their money, goods, labor or skill for the purpose of carrying on a trade, profession, or business and when there is a community of interest in the profits and losses.

Commissioner v. Tower, 327 U.S. 280, 286 (1946), citing, ***Ward v. Thompson***, 22 How. 330, 333, 334 (1959). In ***Culbertson***, 337 U.S. at 743, the Supreme Court articulated an intent test as to whether a partnership exists; namely, whether "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." ***Id.*** The Court also identified the following

attributes as manifestations of an intent to create a partnership:

> the agreement, the conduct of the parties in execution of its provision, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of the income and the purposes for which it is used, and any other facts throwing light on their true intent...

Id. at 742. ***Luna v. Commissioner***, 42 T.C. 1067, 1077-78 (1964), identifies still other factors germane to determining whether an entity is a partnership:

> the existence of an agreement, the contributions made by each party, the parties' control over income and capital, the right of each party to make withdrawals, the sharing of a mutual proprietary interest in the net profits, an obligation to share losses, receiving contingent compensation in the form of a percentage of income....

When viewed in light of these criteria, the NCBA seemingly begins to edge out of the partnership category.

There was no partnership agreement. NCE members signed agency agreements with the NCBA. See Gov't Ex. A-17. There was not a commonality of interest between members in profits and losses generated by the NCBA. "Profits" in the economic sense--revenue generated by the NCE, book sales and seminars--were either in the sole control of John Grandbouche (and later John Voss) through the Founder's Fund, or used to pay the salaries of NCBA office workers. These profits were not shared by NCBA members, and there was no community of interest between members for these profits. At best, these profits were realized solely by the 'inner-circle' of the NCBA, who were paid out of these revenues and made their livelihood at the NCBA.

The government's theory is that the profits NCBA members enjoyed were "saved tax profits;" that is, profits made by not paying income tax on assets enscronced in the NCE or money saved through tax avoidance schemes learned from the NCBA. This theory is unsustainable. For one, there is no evidence that there was a community of interest among all NCBA or NCE members to make "saved tax profits." More importantly, "saved-tax profits" are not what is meant by "profits" under the Internal Revenue Code. Profits generally mean economic profits, not tax savings. See, e.g., ***Herrick v. Commissioner***, 85 T.C. 237 (1985) ("Profit" means economic, not tax, gains for purposes of I.R.C. Section 162(a)); ***Surloff v. Commissioner***, 81 T.C. 210 (1983); ***Slifka v. Commissioner***, 182 F.2d 345 (2d Cir. 1950). Losses sustained by the NCBA because of the price stabilization plan, meanwhile, evince an intent that NCE members be shielded from, not share in, losses sustained by the enterprise. Members with NCE accounts controlled the assets in their own account and no others. The only example of NCBA/NCE assets being pooled was the Founder's Fund, and it was under the sole control of John Grandbouche, and later John Voss.

The lack of profits or a community of interest is not determinative of the NCBA's status for tax purposes. I.R.C. Section 761(a) does not require that an entity report profits to be deemed a partnership. In fact, partnerships have often been constituted in order to show losses for the tax benefits.

More to the point, the Supreme Court and tax court cases involved different situations from the one presented herein. There the choice was between taxable entities, a partnership on one hand and a specific taxable alternative on the other. ***Luna***, for instance, involved the choice between whether the claimant was in a partnership or an employer-employee relation. 42 T.C. at 1067. In ***Culbertson***, 337 U.S. at 735, the choice was between a sole proprietorship and a

partnership. *Tower*, 327 U.S. at 282, involved attribution of income either to a husband and wife as a partnership, or to the husband solely, as an individual. Here, the NCBA attempts to say it is neither a partnership, or to the husband solely, as an individual. Here, the NCBA attempts to say it is neither a partnership, nor anything else for purposes of the federal income tax laws. It simply falls through the cracks.

That an entity might fall through the cracks of the revenue code is not inconceivable. It comes down to the question whether the income tax laws encompass the entire universe of economic activity--with the definition of a partnership corralling all outlier entities--or whether there are gaps in the tax code that impose no requirements on entities like the NCBA. The Tower, Culbertson and Luna cases are aimed a a different set of circumstances. The dispute there is whether the taxpayer is to be treated as part of a partnership and be liable for one type of tax liability, or alternatively be held liable as another type of taxable entity. Those cases then are defining the characteristics between formal categories of taxable status, individuals from partnerships, partnerships from agency relations. The language of I.R.C. Section 761(a) crucial to this case--defining "group[s]" or "other unincorporated association[s]" as partnerships--is not concerned with the dividing lines between categories of tax status, but was meant to reach out and embrace organizations not contained within the formalistic definitions of the tax code.

The NCBA is one such entity encompassed by this definition and as such was required to file an informational return pursuant to I.R.C. Section 6031(a). The amount of economic activity engaged in by the NCE and NCBA--buying and selling metals, selling books, underwriting an insurance program--simply cannot fall through the cracks of the federal tax laws. The consequences of accepting the NCBA's argument that an entity can be organized such that it has no

status for purposes of the Internal Revenue Code would be debilitating to the tax system. In no time at all many non-partnerships patterned after the NCBA would spring up to enjoy the significant tax advantages afforded by being amorphous.

The NCBA failed to meet its burden that the IRS erroneously assessed the Section 6698 penalty. The deliberate formlessness and secrecy of the NCE, made it reasonable for the IRS to asses this penalty. The NCE was the core of the financial operations, accordingly the partnership could most plausibly be defined as all NCE account-holders. The NCBA provided no way to determine who specifically held accounts a the NCE. Therefore, given that NCBA membership conferred the right to an NCE account, all NCBA members may be considered partners for Section 6698 purposes.

The NCBA raised two affirmative attempts at self-definition at trial to escape the "IRS pigeonhole" of being a partnership: 1. the NCBA claimed it was a political organization; and, alternatively, 2. the NCBA claimed to be a sole proprietorship. The evidence revealed neither of these characterizations to be true. The NCBA was neither an exempt political organization as defined by I.R.C. Section 527(e)(1-2), or the sole proprietorship of John Grandbouche. The NCBA's involvement with Grandbouche's campaign in 1982 was marginal, at best, and was certainly not its animating purpose. Dissemination of a broad political message, as was done by the NCBA, does not qualify for exemption under I.R.C. Section 527(e)(2). Such activity must be directed at efforts for an individual, no diffuse proselytization about an ideology. Furthermore, even if it was a political organization, the NCBA still had an obligation to report "political organization taxable income" as defined by I.R.C. Section 527(c). The NCBA certainly generated such income through operation of the NCE.

Likewise, the NCBA was not a sole proprietorship of John Grandbouche. Even the NCBA seems to abandon that position in its post-trial brief. NCBA members' own testimony negates this characterization. John Grandbouche's deposition testimony, admitted at trial, characterizes the NCBA as being governed by its members. John Voss testified that he did not consider the NCBA his sole proprietorship upon taking over as its head. There was simply no convincing evidence that the NCBA was a sole proprietorship.

It should be kept in mind here that all the NCBA was required to do by the Code was file an informational partnership tax return. I.R.C. Section 6031(a). The evidence at trial showed that the NCBA made deliberate strides to elude categorization under the revenue code. In the meantime, the NCE was engaging in a substantial amount of financial activity having significant tax consequences. The breadth of Section 761(a) captures the NCBA/NCE within it. As such, the NCBA was required to file informational returns with the IRS and could be penalized pursuant to Section 6698 for failing to do so.

III. I.R.C. Section 6700 refund claim

In pertinent part, I.R.C. Section 6700 provides for imposition of a penalty against:

(a) --Any person who--

(1)(A) organizes (or assists in the organization of)--

(i) a partnership or other entity,

(ii) any investment plan or arrangement, or

(iii) any other plan or arrangement, or

(B) participates in the sale of any interest in an entity or plan or arrangement referred to in subparagraph (A), and

(2) makes or furnishes (in connection with such organization or sale)--

(A) a statement with respect to the allowability of any deduction or credit, the excludability of any income, or securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter....

The IRS imposed an initial penalty against the NCBA for $20,000,000, which has since been abated to $176,822. The IRS bears the burden of proving the Section 6700 penalty. I.R.C. Section 6703(a).

United States v. Savoie, 594 F.Supp. 678, 680-81 (W.D.La. 1984), ***United States v. White***, 583 F.Supp. 1118, 1119-20 (D.Minn. 1984), ***aff'd***, 769 F.2d 511, 515-518 (8th Cir. 1985), and ***United States v. Kaun***, 633 F.Supp. 406 (E.D.Wis. 1986), ***aff'd***, 827 F.2d 1144, 1147-49 (7th Cir. 1987) are cases enjoining the respective defendants pursuant to I.R.C. Section 7408 for promoting false and fraudulent schemes to avoid taxes in violation of I.R.C. Section 6700.

The defendants in those cases shared many of the positions of the NCBA; for instance: 1. that wages are excludable from gross income; 2. that the income tax is unconstitutional as a direct tax not apportioned among the states; 3. that the duty to pay income taxes is dependent upon receiving a privilege from the government. ***Savoie***, 594 F.Supp. at 681; ***White***, 583 F.Supp. at 1119-20. Each of these positions has been deemed frivolous. See ***Lonsdale v. United States***, 919 F.2d 1140, 1448 (10th Cir. 1990).

That the NCBA advocated and advised members positions deemed frivolous by the courts is indisputable. The "Freedom Books," as well as other NCBA pamphlets and promotional materials, presented and counseled readers to

assert frivolous tax positions. The NCBA also knew or had reason to know that these positions were frivolous. See ***Savoie***, 594 F.Supp. at 681. The NCBA and its main theoreticians were veterans in advocating resistance to the IRS. While they may adamantly have believed in their righteousness, they also knew that courts have uniformly rejected their teaching.

Turning to the statute, this court has already ruled that the NCBA is a person under Section 6700. Next, to be held liable, the NCBA must be found to have "organize[d] (or assist[ed] in the organization of) either, (i) a partnership or other entity, (ii) any investment plan or arrangement, or (iii) any other plan or arrangement." The NCE amounts to the "other plan or arrangement." Finally, the NCBA must have "participate[d] in the sale of any interest in an entity or plan or arrangement previously referred to" and "have made or furnished a statement with respect to the allowability of any deduction or credit, the excludability of any income, or securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to now is false or fraudulent as to any material matter,..." The question becomes whether the NCE represented members could secure a tax benefit "by reason of their participation" in the NCE.

The evidence revealed that the NCBA/NCE did made representations about the tax advantages afforded by maintaining an account. The emphasis on account-holders privacy and common law rights of contract were pointed messages that account-holders could avoid the IRS. This privacy, then, would be an "other tax benefit" gained "by reason of holding an interest" in the NCE. Equally important is evidence of the number of NCBA members convicted of tax crimes. This evidence permits an inference the people joined the NCBA in order to secure tax benefits and that the

NCBA, through the vehicle of the NCE, promoted and sold interests in an abusive tax shelter. This court concludes that the government met its burden in proving that the NCBA/NCE is liable for the Section 6700 penalty.

The NCBA contends that its materials were mere advocacy and did not approach promotion of an abusive tax shelter. This is not supported by the evidence. Perhaps the NCBA Freedom Books, standing alone, would amount to mere advocacy. But the NCBA went so far as to establish the NCE and tout the privacy it afforded to members. The NCE was clearly established to thwart enforcement of the tax laws, and as such was an abusive tax shelter. The NCBA went far beyond mere advocacy.

III. Constitutional Challenges

The NCBA raises constitutional challenges to the Section 6698 and Section 6700 penalties, specifically contending that the Section 6698 penalty is an attempt to impose record-keeping requirements on the NCBA in violation of the Fifth Amendment and also contending that both penalties are the product of an IRS vendetta to squelch NCBA members' First Amendment right of free association and speech.

First, the NCBA contends that forcing it to file informational partnership returns would violate the Fifth Amendment privilege against self-incrimination. This blanket fifth amendment claim has been repeatedly rejected. See, ***United States v. Stillhammer***, 706 F.2d 1072, 1076 (10th Cir. 1983); ***United States v. Lawson***, 670 F.2d 923, 927 (10th Cir. 1982). In addition, a partnership does not enjoy the same fifth amendment protection that an individual does, and can be compelled to produce records. ***Bellis v. United States***, 417 U.S. 85, 100 (1974). The NCBA's fifth amendment justification for failing to file returns must fail.

Second, the NCBA contends the penalties were a pretext to destroy individual members' First Amendment right of free association and speech. The first amendment prohibits Congress from passing laws "abridging the freedom of speech ... or the right of the people to peaceably assemble, and to petition the government for redress of grievances." U.S. Const. Amend. 1. The NCBA claims the right to "freedom of association" and "free speech" affords it protection from the penalties. It further alleges a decade long IRS conspiracy against it has led to the deprivation of members' First Amendment rights.

The evidence at trial revealed no such conspiracy. The penalties the IRS imposed against the NCBA were lawful and warranted. That the IRS struggled in it characterization of the NCBA is understandable in light of the NCBA's protean form. Moreover, the not-coincidental correspondence between convicted tax offenders and NCBA members justified the IRS' interest in NCBA activities. See Gov't exhibit G-11 (listing NCBA members convicted of violating tax laws). The evidence revealed not an overzealous government agency bent on destruction of a legitimate political movement; but rather an agency given cause to investigate an organization encouraging violation of the revenue laws. In short, the NCBA failed to prove a government conspiracy to deprive its members of protected constitutional rights.

Finally, the NCBA contends the penalties impermissibly squelch freedom of speech. Courts have been loth to deem messages like that of the NCBA protected political speech. In *White*, 769 F.2d at 516, the court characterized the defendant's activities as commercial speech, and thus not protected because it promoted an illegal activity or transaction. There, defendant White directed and founded an organization that promoted and sold written materials and cassettes that presented "frivolous arguments against the constitutionality and legality of the federal income tax

system." 583 F.Supp. at 1119. The organization sold the materials for $50, and also sold memberships for $250. ***Id.*** Likewise, in ***United States v. Buttorff***, 761 F.2d 1056, 1066-68 (5th Cir. 1985), the defendant's first amendment defense was rejected on the basis that the frivolous tax positions he advocated were pure commercial speech and subject to regulation for promoting an illegal activity. See ***In re R.M.J.***, 455 U.S. 191, 203 (1982). ***Kaun***, 633 F.Supp. at 418, also ruled the tax protest materials to be sanctionable commercial speech. Commercial speech that is false, misleading, fraudulent, or illegal enjoys no constitutional protection. ***Virginia Pharmacy Board v. Virginia Citizens Consumer Council***, 425 U.S. 748, 770-73 (1976).

The NCBA contends that the more stringent standard of ***Brandenburg v. Ohio***, 395 U.S. 444, 447 (1969), applies to its activities and thus the Section 6700 penalty could not be imposed absent a finding that its advocacy was "directed to inciting or producing imminent lawless action and is likely to incite or produce such action." A footnote in the Seventh Circuit's opinion in ***Kaun***, 827 F.2d at 1151 n. 3, expresses first amendment reservations about Section 6700: "It is therefore possible that the broad scope of Section 6700 may reach a person who merely advocates the nonpayment of taxes in general. This result would clearly run afoul of ***Brandenburg***."

As was said before, though, the NCBA went beyond advocating nonpayment of taxes in general. It established a financial arm, the NCE, that actually put into practice the NCBA's anti-tax principles. Insofar as the Section 6700 penalty was levied against the activities and promotion of the NCE, the NCBA was engaging in commercial speech subject to lessened first amendment protection. The case is no different from the rejected first amendment challenges to Section 6700 in ***White***, ***Kaun***, and ***Buttorff***. The NCBA's promotion of the NCE involved making statements the

promoters knew to have been rejected by the federal courts. As such, this speech was sanctionable under Section 6700. The First Amendment does not protect the NCBA from the consequences of its statements and actions.

Upon the foregoing, it is

ORDERED that judgment will enter dismissing all of the claims of the National Commodity and Barter Association/National Commodity Exchange with prejudice and awarding costs to the defendant.

DATED: 22 October 1993

BY THE COURT
Richard P. Matsch, Judge

APPENDIX B - 1

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Appeal No. 93-1495
(D.C. No. 89-M-1912, Dist. of Colo.)

NATIONAL COMMODITY AND BARTER ASSOCIATION; NATIONAL COMMODITY EXCHANGE,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee.

ORDER AND JUDGMENT*

Before **TACHA, McWILLIAMS** and **BARRETT**, Circuit Judges.

National Commodity and Barter Association (NCBA) appeals from the district court's Order dismissing its claims for a refund of the tax penalties assessed under I.R.C. Section 6698 for failing to file partnership tax returns for 1979 through 1988 and the tax penalty assessed under I.R.C. Section 6700 for promoting an abusive tax shelter.

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* This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. The court generally disfavors the citation of orders and judgments; nevertheless, an order and judgment may be cited under the terms and conditions of the court's General Order filed November 29, 1993. 151 F.R.D. 470.

APPENDIX B - 2

Facts

The NCBA is a self-described "voluntary, non-commercial, political and educational association" conceived by John Grandbouche (Grandbouche), a proponent of libertarian and anti-monetarist ideas. Grandbouche was the director of the NCBA from its inception, sometime in 1978 or 1979, until his death in 1986, at which time, John Voss became the director. Over the course of the 1980's, the NCBA recruited members and charged annual membership fees ranging from $100 to $180. NCBA membership was about 200 in 1979 and peaked at nearly 2,000 in the early 1980's. Each member of the NCBA was entitled to certain benefits including the monthly newsletter, a multi-volume set of loose-leaf "Freedom Books," use of the Mutual Assistance Plan (MAP), and an account at the National Commodity Exchange (NCE).

The NCE was a warehouse bank created by the NCBA to function outside the Federal Reserve System. It was available to NCBA members only. The NCE accepted depositor's money to purchase gold and silver and all deposits at the NCE were held in that form. The NCE provided a "price stabilization plan" to protect account holders' assets from price fluctuations in the precious metals market. In addition, the NCE offered a bill paying service whereby account holders would notify the NCE of bills they had to pay and to whom. The NCE maintained checking accounts at several Denver area banks and would write checks on one of its own accounts to pay the bills.

Not all members of the NCBA used the NCE. Records seized by the IRS showed 679 accounts at the NCE. Most accounts were held by individuals; however, some belonged to other warehouse exchanges located around the country.

On April 5, 1985, the IRS levied a $20,000,000 penalty against the NCBA pursuant to Section 6700 for promoting an abusive tax shelter by disseminating false and fraudulent

statements concerning the federal tax laws. Concurrent with the penalty, and pursuant to a search warrant, the IRS conducted a search and seizure of the NCBA's offices in Denver, Colorado, seizing cash and coins, as well as, gold and silver bullion.[1] The IRS also placed levies against NCBA's bank accounts. The IRS retained the NCBA's assets to satisfy the Section 6700 penalty.

On June 22, 1990, the IRS assessed $4,223,000 in penalties against the NCBA under Section 6698 for failing to file partnership tax returns for 1979 through 1988.

In January, 1991, the IRS abated the $20,000,000 Section 6700 penalty to $176,822 after a number of courts disapproved the method by which the penalty was calculated. Under the new computation method, the IRS penalized the NCBA based on a percentage of its gross income, which the IRS determined to be $2,384,226 for 1982 through 1985. The IRS applied the "overpayment" of the Section 6700 penalty, caused by the abatement, to the Section 6698 penalties. The "overpayment" satisfied the Section 6698 penalties for 1979 through 1983. After the IRS denied its refund claims, the NCBA filed a claim in the district court for a refund of the Section 6698 penalties for 1979 through 1983, an injunction against the IRS to prevent the IRS from enforcing the Section 6698 penalties for 1984 through 1988, and a refund of the Section 6700 penalty.

Issues

On appeal, NCBA contends that the district court erred in (1) finding that the NCBA was required to file informational partnership tax returns for 1979 through 1988 and could be penalized pursuant to Section 6698 for failing to do so, and

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[1] In an earlier opinion of this court the search and seizure was held unconstitutional and the IRS was ordered to return all the seized assets. ***Voss v. Bergsgaard***, 774 F.2d 402, 406 (10th Cir. 1985)

(2) upholding the IRS's Section 6700 penalty for promoting an abusive tax shelter.

I.

The NCBA asserts that the district court erroneously found it was subject to Section 6698 penalties for failing to file informational partnership tax returns for the years 1979 through 1988.

The NCBA concedes that it is required to file informational partnership tax returns.[2] However, the NCBA asserts that it is not liable for any penalty under I.R.C. Section 6698(b) because it had "reasonable cause" for not filing. The NCBA contends reasonable cause existed because (1) "prior decisions of this ... court protected the privacy of NCBA's membership information," (2) "the trial court has issued inconsistent rulings relating to NCBA's legal status," (3) "[t]he NCBA had no prior notice that it should have considered itself to be a partnership for tax purposes," and (4) "NCBA met its burden of proving a partnership of much smaller proportions than the court found."

Under I.R.C. Section 6698 if a partnership required to file a return under section 6031 for any taxable year fails to file it "shall be liable for a penalty ... unless it is shown that such failure is due to reasonable cause." 26 U.S.C. 6698. However, the "reasonable cause" issue raised by NCBA on

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[2] The NCBA refutes the characterization as a "partnership" but concedes that it is required to file the informational return under the "catch all" provision of I.R.C. Section 761(a) which defines a "partnership" for federal tax purposes as follows:

> [T]he term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation, a trust or an estate.

26 U.S.C. Section 761(a)

appeal was not adequately raised, preserved or presented by NCBA to the district court. This court will not address issues that were not presented to and ruled upon by the district court.[3] ***Farmers Ins. Co., Inc. v. Hubbard***, 869 F.2d 565, 570 (10th Cir. 1989). See also ***Burnette v. Dresser Industries, Inc.***, 849 F.2d 1277, 1282 (10th Cir. 1988); ***Graham v. City of Oklahoma City, Okla.***, 859 F.2d 142, 146 n. 6 (10th Cir. 1988) ("We will not consider issues which were not raised before the district court.").

Although the NCBA raised arguments (1) and (4) in support of its reasonable cause claim in the district court as independent grounds for relief, it has not asserted these claims independently on apeal. Thus, by its own failures or inactions, NCBA rendered its inappropriate for us to consider the above theories of relief on appeal.

II.

The NCBA contends that the district court erroneously determined that it promoted an abusive tax shelter and erred in upholding the $176,822.00 penalty under I.R.C. Section 6700.

The NCBA argues that it "promotes political, educational and economic ideas, including ideas about taxation, none of which suggests that NCBA activities confer any 'tax benefit' by reason of association with or participation in any NCBA

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[3] The narrow exceptions to this general rule relate to issues of jurisdiction in the "case or controversy" limitation of article 3, section 2 of the United States Constitution, questions of sovereign immunity, ***Farmers Ins. Co., Inc. v. Hubbard***, 869 F.2d 565, 570 (10th Cir. 1989) (citations omitted), and cases where "the appellate court feels it must resolve a question of law to prevent a miscarriage of justice." ***Hicks v. Gates Rubber Co.***, 928 F.2d 966, 970 (10th Cir. 1991). See also ***Unicover World Trade Corp. v. Tri-State Mint, Inc.***, 24 F.3d 1219, 1221 (10th Cir. 1994) ("We will consider an issue that was not preserved for appeal only on a showing of manifest error.") (citations omitted). These exceptions do not apply in this case.

'plan or arrangement.'" NCBA claims that it was "formed to disseminate political ideas" and that "[f]or members of the NCBA, the exchange [NCE] is a mode of political expression" protected by the First Amendment. Finally, the NCBA asserts that an individual must personally make or furnish the false or fraudulent statements in order to be liable and that a partnership would not impute liability to all partners simply because one partner had made or furnished false or fraudulent statements in violation of Section 6700.

"Findings of fact ... shall not be set aside unless clearly erroneous. Fed.R.Civ.P. 52(a). "A finding of fact is not clearly erroneous unless 'it is without factual support in the record, or if the appellate court, after reviewing all the evidence, is left with the definite and firm conviction that a mistake has been made.'" ***Las Vegas Ice & Cold Storage Co. v. Far West Bank***, 893 F.2d 1182, 1185 (10th Cir. 1990) (quoting ***LeMaire ex rel. LeMaire v. United States***, 826 F.2d 949, 953 (10th Cir. 1987)).

The district court found that: "the NCBA is a person under Section 6700;" "the evidence revealed that the NCBA/NCE did made [sic] representations about the tax advantages afforded by maintaining an account" at the NCE; and the NCE was "clearly established to thwart enforcement of the tax laws, and as such was an abusive tax shelter."

After careful examination of the record, we cannot say the district court's findings are clearly erroneous.

AFFIRMED.

Entered for the Court:
James E. Barrett,
Senior United States
Circuit Judge

APPENDIX C - 1

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Appeal No. 93-1495

NATIONAL COMMODITY AND BARTER ASSOCIATION; NATIONAL COMMODITY EXCHANGE,
Plaintiffs-Appellants,
v.
UNITED STATES OF AMERICA,
Defendant-Appellee.

ORDER
Entered February 6, 1995

Before **TACHA, McWILLIAMS** and **BARRETT**, Circuit Judges.

This matter comes on for consideration of appellant's petition for rehearing and suggestion for rehearing in banc.

Upon consideration whereof, the petition for rehearing is denied by the panel that rendered the decision.

In accordance with Rule 35(b), Federal Rules of Appellate Procedure, the suggestion for rehearing in banc was transmitted to all of the judges of the court who are in regular active service. No member of the panel and no judge in regular active service on the court having requested that the court be polled on rehearing in banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing in banc is denied.

Enter for the Court

PATRICK FISHER, Clerk
By Audrey F. Weigel
Deputy Clerk

§ 6700. Promoting abusive tax shelters, etc.

(a) Imposition of penalty. Any person who--

(1) (A) organizes (or assists in the organization of)--

(i) a partnership or other entity,

(ii) any investment plan or arrangement, or

(iii) any other plan or arrangement, or

(B) participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement referred to in subparagraph (A), and

(2) makes or furnishes or causes another person to make or furnish (in connection with such organization or sale)--

(A) a statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter, or

(B) a gross valuation overstatement as to any material matter, shall pay, with respect to each activity described in paragraph (1), a penalty equal to the $1,000 or, if the person establishes that it is lesser, 100 percent of the gross income derived (or to be derived) by such person from such activity. For purposes of the preceding sentence, activities described in paragraph (1)(A) with respect to each entity or arrangement shall be treated as a separate activity and participation in each sale described in paragraph (1)(B) shall be so treated.

(b) Rules relating to penalty for gross valuation overstatements.

(1) Gross valuation overstatement defined. For purposes of this section, the term 'gross valuation overstatement' means any statement as to the value of any property or services if--

(A) the value so stated exceeds 200 percent of the amount determined to be the correct valuation, and

(B) the value of such property or services is directly related to the amount of any deduction or credit allowable under chapter 1 to any participant.

(2) Authority to waive. The Secretary may waive all or any part of the penalty provided by subsection (a) with respect to any gross valuation overstatement on a showing that there was a reasonable basis for the valuation and that such valuation was made in good faith.

(c) Penalty in addition to other penalties. The penalty imposed by this section shall be in addition to any other penalty provided by law.

§ 6698. Failure to file partnership return.

(a) General rule. In addition to the penalty imposed by section 7203 (relating to willful failure to file return, supply information, or pay tax), if any partnership required to file a return under section 6031 for any taxable year--

(1) fails to file such return at the time prescribed therefor (determined with regard to any extension of time for filing), or

(2) files a return which fails to show the information required under section 6031, such partnership shall be liable for a penalty determined under subsection (b) for each month (or fraction thereof) during which such failure continues (but not to exceed 5 months), unless it is shown that such failure is due to reasonable cause.

(b) Amount per month. For purposes of subsection (a), the amount determined under this subsection for any month is the product of--

(1) $ 50, multipled by

(2) the number of persons who were partners in the partnership during any part of the taxable year.

(c) Assessment of penalty. The penalty imposed by subsection (a) shall be assessed against the partnership.

(d) Deficiency procedures not to apply. Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by subsection (a).

Supreme Court, U.S.
FILED
JUN 26 1995
OFFICE OF THE CLERK

No. 94-1823

In the Supreme Court of the United States

OCTOBER TERM, 1994

NATIONAL COMMODITY AND BARTER ASSOCIATION, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner was correctly found liable for penalties under 26 U.S.C. 6698 for its failure to file income tax returns required by 26 U.S.C. 6031.

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In the Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-1825

NATIONAL COMMODITY AND BARTER ASSOCIATION, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B1-B6) is unofficially reported at 74 A.F.T.R. 2d (RIA) 94-7385 and is noted at 42 F.3d 1406 (Table). The opinion of the district court (Pet. App. A1-A23) is reported at 843 F. Supp. 655.

JURISDICTION

The judgment of the court of appeals was entered on November 29, 1994. The petition for rehearing was denied on February 6, 1995. Pet. App. C1. The petition for a writ of certiorari was filed on May 5, 1995. The

jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. Petitioner[1] describes itself as a "voluntary, non-commercial, political and educational association" (Pet. App. A1-A2, B2). Founded in 1979, petitioner had approximately 2,000 members in the early 1980s (*id.* at B2). Petitioner operated a "warehouse bank," known as the National Commodity Exchange (NCE), which conducted a substantial volume of business (*id.* at A2, A17). According to the former manager of the bank's day-to-day operations, the bank had gross receipts of approximately $25,000,000 in 1984 (C.A. Supp. App. 349-350). Records obtained from two of the commercial banks at which petitioner maintained accounts established that petitioner made deposits at those banks in excess of $17,000,000 in 1983 and in excess of $15,000,000 in 1984 (*id.* at 346). Petitioner refused to provide information about the accounts it maintained at other banks. See, *e.g.*, *In re First Nat'l Bank*, 701 F.2d 115 (10th Cir. 1983).

Petitioner's "warehouse banking" system was designed to thwart enforcement of the federal tax laws

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[1] In the pleadings, the National Commodity and Barter Association/National Commodity Exchange represented itself as a single plaintiff, stating that "Plaintiff, National Commodity and Barter Association/National Commodity Exchange ('NCBA/NCE') is a voluntary, non-commercial, political and educational association" (C.A. App. 1). In its notice of appeal, the National Commodity and Barter Association/National Commodity Exchange again described itself as a single entity (*id.* at 141). Although the National Commodity and Barter Association/National Commodity Exchange now states in the petition that it is two distinct parties, we nevertheless refer to that entity as "petitioner."

by providing a means for taxpayers to conceal their income and assets (Pet. App. A4, A20). According to literature distributed by petitioner, it was "impossible, with the NCE system, for the IRS to violate your privacy and establish either civil or criminal liability against you" (C.A. Supp. App. 337, 343). Under the NCE system, a member would open an account that identified him only by an account number and not by name. The member would then deposit funds into the NCE account and receive a "warehouse receipt" for the amount of gold or silver that was allegedly purchased with the deposit (*id.* at 266, 343). When a member deposited a check into his NCE account, petitioner would negotiate it along with several hundred other checks so that, as petitioner's literature explained, "no one is going to know who or what belongs to whom. Not without an *extensive* amount of research, at least" (*id.* at 345).

Petitioner did not keep records of its members' deposits. Instead, it kept only the last "warehouse receipt" for each account. That receipt showed the account balance and the account number but contained "no summation of [the member's] transaction activity" (C.A. Supp. App. 343). Petitioner's literature asserted that the account offered by petitioner was "similar to a Swiss bank account" but "much better" (*ibid.*).[2]

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[2] Petitioner's warehouse banking account also provided "paper-trail" protection on the withdrawal side of the banking transaction. For example, if a member needed to pay another exchange member, he could accomplish it through an account-to-account transfer that left no record of the transaction at the exchange. If a third party was involved, the exchange member would send his bill or invoice from the third party to the exchange and the exchange would pay it using an exchange check that did not identify the member. The member would

Many of petitioner's members used its "warehouse banking" system in an effort to evade taxes. See, *e.g.*, *United States* v. *Dack*, 987 F.2d 1282, 1285 (7th Cir. 1993) (member "followed the tax protestor strategy of * * * utilizing a warehouse bank run by a protester organization in an attempt to hide his money and his monetary transactions from the IRS"); *United States* v. *Becker*, 965 F.2d 383 (7th Cir. 1992) (doctor used NCE account to evade more than $300,000 in federal income taxes on $850,000 of income earned from practice of medicine), cert. denied, 113 S. Ct. 1411 (1993); *United States* v. *Hawley*, 855 F.2d 595, 598 (8th Cir. 1988 ("circuitous check-cashing system allowed NCBA members to convert checks into cash without leaving any record at a commercial bank of a cash withdrawal attributable to them"), cert. denied, 489 U.S. 1020 (1989); *United States* v. *Stelten*, 867 F.2d 446, 451 (8th Cir.) ("customer's warehouse receipt file is proof of the way in which he or she used the NCE's financial services to conceal income"), cert. denied, 493 U.S. 828 (1989); *In re Grand Jury Proceeding*, 842 F.2d 1229, 1230 (11th Cir. 1988) ("The financial system operated by NCBA obviously provides significant opportunities for the evasion of federal tax laws, especially requirements for the reporting of taxable income.").

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receive a copy of the check and a warehouse receipt showing a new (reduced) account balance. As in the case of a deposit, the only record kept by the exchange was a copy of the last warehouse receipt. The receipt provided the current account balance but did not contain information about the member's transaction (C.A. Supp. App. 117-118, 266-267, 273, 274, 277, 302, 326-327, 343).

b. There were two types of fees charged for NCE services (C.A. Supp. App. 283-285). First, an annual membership fee was charged that ranged from $100 to $180 (Pet. App. A3). Second, petitioner's members paid transaction charges for use of the bank. Deposit fees ranged from 1.25% of the deposit amount for large deposits to 4.5% of the deposit amount for small deposits (C.A. Supp. App. 283-284). Additional charges were assessed for other services, such as mailing cash by registered mail (*id.* at 54, 117-118).

Petitioner's newsletter was sent to all of its members. The newsletter represented that "[t]he Warehouse Exchange always belonged to the members" (C.A. Supp. App. 314) and that "[t]he NCE was a service wing of the NCBA * * * that * * * benefited all members jointly" (*id.* at 313). In petitioner's words, "[t]he entire association membership functions in the capacity of a bank board of directors" with respect to loans made to petitioner's members through the exchange mechanism (*id.* at 343) and "[w]hen an NCBA warehouse makes purchases [of gold and silver], they do so * * * on behalf of the association, not the member" (*id.* at 309).

Petitioner also published "Freedom Books" describing its official position. These books contained the following "*WARNING*" (C.A. Supp. App. 150; see Pet. App. A3):

> THE AUTHOR DOES NOT RECOMMEND FILING A TAX RETURN. PERSONS FILING ANY TAX RETURN AT ALL DO SO AT THEIR OWN RISK!

From 1979 through 1988, petitioner followed its own advice and did not file any federal tax return (Pet. App. A7; C.A. Supp. App. 8). Petitioner also did not provide its members, employees or contractors with forms

reporting their income (C.A. App. 261; C.A. Supp. App. 8, 53, 66, 69, 105). Nor did petitioner seek or obtain a ruling from the IRS that it was a non-profit or tax-exempt organization (Pet. App. A7).

c. On June 22, 1990, the Internal Revenue Service assessed penalties against petitioner in the total amount of $4,223,000 under Section 6698 of the Internal Revenue Code (Pet. App. A2). Section 6698 provides penalties for a taxpayer's failure to file partnership income tax returns. 26 U.S.C. 6698. The amount of the penalty "for any month is the product of * * * $50, multiplied by * * * the number of persons who were partners in the partnership during any part of the taxable year." 26 U.S.C. 6698(b). The penalty may be imposed for a maximum of five months for any taxable year. 26 U.S.C. 6698(a). In assessing the penalty, the Service determined that petitioner had 1,498 partners in each of the years 1979 through 1983, 1,962 partners in 1984, and 1,860 partners in each of the years 1985 through 1988 (C.A. App. 326). The Service computed the amount of the penalty assessment for each year by multiplying $250 ($50 per partner for a maximum of five months) times the number of partners.

The penalty assessments for 1979 through 1983 were satisfied by application of an overpayment resulting from a partial abatement of penalties previously assessed against petitioner under Section 6700 of the Code. Petitioner filed administrative claims for refund with respect to the Section 6698 penalties for the years 1979 through 1983 (Pet. App. B3). After the IRS denied those claims, petitioner filed suit in district court to obtain a refund of the penalties it had paid and an injunction to prevent the Service from collecting

the penalties that remained outstanding.[3] The pleadings alleged six "grounds for recovery" (C.A. App. 6) but did not contend that petitioner had reasonable cause for failing to file partnership returns (*ibid.*).

The district court concluded that petitioner failed to meet its burden of proving that the Service had erroneously assessed the Section 6698 penalty (Pet. App. A16). The court rejected petitioner's assertion that it was not a partnership. The definition of a partnership under Section 761(a) of the Internal Revenue Code includes any "syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on" (26 U.S.C. 761(a)). The court noted that this statutory definition is significantly broader in scope than the common law concept of a "partnership" (Pet. App. A10-A11) and that "[t]he breadth of the statutory term indicates it was designed as a catch-all so as to encompass consciously amorphous associations such as [petitioner]" (*id.* at A11-A12). The court concluded that petitioner carried on a significant amount of "financial operation[s]" and therefore fell within the broad reach of Section 761(a) (Pet. App. A17).

The court explained that "[t]he deliberate formlessness and secrecy of the NCE, made it reasonable for the IRS to assess this penalty" (Pet. App. A16). Because "[t]he NCE was the core of the financial operations, * * * the partnership could most plausibly be defined as all NCE account-holders" (*ibid.*). Since

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[3] The suit that was initially filed sought a refund of penalties assessed under Section 6700 of the Code. Petitioner does not request review of the Tenth Circuit's holding in favor of the government on that issue (Pet. 5).

petitioner provided no way to determine who specifically held accounts at the NCE, the court concluded that, in computing the penalty under Section 6698, it was appropriate to regard all of petitioner's members as partners of the organization (Pet. App. A16).

The court rejected petitioner's assertion that "the penalties were a pretext to destroy individual members' First Amendment right of free association and speech" and that "a decade long IRS conspiracy against it has led to the deprivation of members' First Amendment rights" (Pet. App. A21). The court found that "the evidence at trial revealed no such conspiracy" (*ibid.*).

2. The court of appeals affirmed (Pet. App. B1-B6). Petitioner conceded on appeal that, because its organization fell within the broad definition of a partnership in Section 761(a), petitioner was required to file informational partnership returns (Pet. App. B4). Petitioner contended, however, that the district court overlooked that a penalty is not imposed under Section 6698 if the taxpayer had "reasonable cause" for failing to file a return; petitioner submitted that its failure to file should have been excused under this provision.

The court of appeals rejected petitioner's contention. The court noted that "the 'reasonable cause' issue" had not been "adequately raised, preserved or presented by [petitioner] to the district court" (Pet. App. B4-B5). The court declined to "address issues that were not presented to and ruled upon by the district court" (*id.* at B5).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Section 6031 of the Internal Revenue Code provides that "[e]very partnership (as defined in Section 761(a)) shall make a return for each taxable year" (26 U.S.C. 6031(a)). Section 6698 of the Code further provides that "if any partnership required to file a return under section 6031 for any taxable year * * * fails to file such return at the time prescribed * * * such partnership shall be liable for a penalty determined under [Section 6698(b)] * * * unless it is shown that such failure is due to reasonable cause" (26 U.S.C. 6698(a)). The term "partnership" is defined for this purpose in Section 761(a) of the Code to "include a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on" (26 U.S.C. 761(a)).

Petitioner has acknowledged that it is a "partnership" within this statutory definition (Pet. App. B4). Petitioner now asserts that it nonetheless should not have been subject to a penalty because its failure to file the required returns was "due to reasonable cause" (26 U.S.C. 6698(a)). As the court of appeals noted, however, petitioner's assertion that it had "reasonable cause" not to file partnership returns had not been "adequately raised, preserved or presented" below and therefore should not be considered on appeal (Pet. App. B4-B5). There is no conflict or other basis warranting further review of that fact-specific application of settled principles by the court of appeals.

Petitioner's reasonable cause argument is, in any event, plainly without merit. As this Court stated in *United States* v. *Boyle*, 469 U.S. 241, 246 (1985) (quoting 26 C.F.R. 301.6651(c)(1) (1984)), "the term 'reasonable cause' is not defined in the Code, but the relevant Treasury Regulation calls on the taxpayer to demonstrate that he exercised 'ordinary business care and prudence' but nevertheless was 'unable to file the return within the prescribed time.'" In this case, petitioner strongly advised its members against filing income tax returns and, following its own advice, filed no returns during the ten-year period from 1979 through 1988 (Pet. App. A7). As the district court held, "even if it was a political organization, [petitioner] still had an obligation to report 'political organization taxable income' as defined by [26 U.S.C.] 527(c). [Petitioner] certainly generated such income through the operation of the NCE" (Pet. App. A16). Petitioner also did not file reporting forms for any of its employees and contractors (see page 6, *supra*) and did not seek a ruling from the Service concerning whether it was exempt from the filing requirements of the Internal Revenue Code (*ibid.*). Petitioner did not exercise even the slightest care, let alone ordinary business care, in deciding not to file returns. It simply carried out its philosophy of deliberate non-filing.

2. There is no merit to petitioner's argument (Pet. 16-22) that its status as a political organization insulated it from the Section 6698 penalty.[4] To qualify

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[4] The government contended in the courts below that, because this claim was not raised in petitioner's administrative claim for refund, it could not be litigated in a tax refund suit. See *United States* v. *Felt & Tarrant Mfg. Co.*, 283 U.S. 269, 272 (1931).

as a "political organization," an organization must be "organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function" as defined in Section 527(e)(1) of the Code. An "exempt function" is defined as (26 U.S.C. 527(e)(2)):

> the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

There is no evidence demonstrating that petitioner was organized and operated primarily for the function of influencing or attempting to influence the selection, nomination, election, or appointment of public officers. To the contrary, petitioner's newsletter frankly declared that its warehouse banking system was "THE HEART OF OUR MOVEMENT" (C.A. App. 288). A former staff member of petitioner testified that "[petitioner] did really nothing to change the government politically or even to try to change any laws" (C.A. Supp. App. 132). The district court thus correctly found (Pet. App. A16) that the evidence did not support petitioner's claim that it was a political organization under Section 527(e).

3. Nor is there merit to petitioner's contention that the court of appeals should have considered "whether [the partnership] was a much smaller partnership than [was] alleged by [the] IRS" (Pet. 10). Petitioner's theory is that its financial operations involved only a

"handful" of partners and that the amount of the penalty should therefore be reduced (Pet. 9).

The district court correctly found that petitioner failed to meet its burden of proof on this issue (Pet. App. A16).[5] Further review of this factual determination, concurred in by both courts below, is not warranted. See, *e.g.*, *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985).

4. Petitioner errs in contending (Pet. 12-14) that the decision in this case conflicts with *Commissioner* v. *Culbertson*, 337 U.S. 733 (1949). In *Culbertson*, the Court considered whether a partnership composed of family members did not qualify as a "partnership" under the Internal Revenue Code—even if it fell within the literal terms of the statutory definition—because it was merely a device to effectuate a division of income in an effort to permit the family to circumvent progressive income tax rates. *Id.* at 735. The question that the Court focussed on was "whether the family partnership is real for income-tax purposes." *Id.* at 741. The Court concluded that even a family may form a valid partnership if there is a "bona fide intent of the parties to join together as partners" (*id.* at 743).

Nothing in *Culbertson* supports any suggestion that the statutory definition of "partnership" is not to be

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[5] Petitioner argues that "[the] IRS bears the burden of proof when it alleges fraudulent conduct on the part of a taxpayer." (Pet. 20). That contention misses the point, however, for fraudulent conduct is not a prerequisite to the imposition of penalties under Section 6698. It is well established that, in a refund suit, the taxpayer, rather than the Commissioner, bears the burden of proving the amount he is entitled to recover. *United States* v. *Janis*, 428 U.S. 433, 440-441 (1976); *Lewis* v. *Reynolds*, 284 U.S. 281, 283 (1932).

given its plain meaning. In the present case, petitioner's status as a "partnership" under Section 761(a) was determined by application of the plain language of the governing statute to a business entity conducting financial operations (Pet. App. A10-A16). As the courts below correctly concluded, the statute applies directly to the facts of this case.

5. Petitioner errs in relying (Pet. 15-23) upon *NAACP* v. *Claiborne Hardware Co.*, 458 U.S. 886 (1982), and *NAACP* v. *Alabama*, 357 U.S. 449 (1958), for the proposition that the penalties assessed in this case violate the First Amendment. Those cases do not hold that an unincorporated association that carries on a substantial financial operation, such as petitioner's warehouse bank, is excused by the First Amendment from complying with the provisions of the Internal Revenue Code.

Similarly, petitioner errs in contending (Pet. 16) that the penalty reflects an improper effort to obtain its membership lists. Here, as in *Pleasant* v. *Lovell*, 974 F.2d 1222, 1233 (10th Cir. 1992), "[t]he evidence does not support [petitioner's] notion that [the] * * * motive [of the IRS employees] was to harass or disrupt [petitioner] in any legal political pursuits."

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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